

NONPROFIT & UNINCORPORATED ORGANIZATIONS COMMITTEE  
BUSINESS LAW SECTION  
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February 5, 2007

Deputy Attorney General Karen Denvir  
Department of Justice  
Office of Attorney General  
P.O. Box 944255  
Sacramento, California 94244-2550

Re: Proposed Regulations to Amend Section 300 of Title 11 of  
California Code of Regulations

Dear Ms. Denvir:

We are writing in response to the Notice of Proposed Action of the Department of Justice ("DOJ") pursuant to which the DOJ will accept written comments on the proposed regulations to amend Section 300 of Title 11 of California Code of Regulations. The proposed amendment includes requirements that certain information be submitted by charitable organizations when applying for initial registration, as authorized under 12587 of the Government Code.

The comments in this letter are provided on behalf of the Nonprofit & Unincorporated Organizations Committee (the "Committee") of the Business Law Section of the State Bar of California (the "Section"), with authorization from the Section's Executive Committee. The Section is composed primarily of attorneys regularly engaged in advising business enterprises and similar organizations in California. The Committee is one of the Section's Standing Committees. The membership of the Committee is comprised mostly of attorneys who regularly advise California nonprofit corporations and out-of-state corporations conducting operations in California, but also includes attorneys who provide assistance on a pro bono basis to organizations that have limited resources.

Summary

This letter presents two principal comments and one minor comment on the proposed regulations.

First, pursuant to the proposed regulations, an initial registration application would require submission of various documents that the registering applicant may not be able to submit in the requisite time period. The proposed regulations should allow submission of an initial registration that could later be supplemented as documents or information become available.

Second, the proposed regulations would require a new organization to disclose information relating to its tax-exempt status and to state whether contributions to it are tax deductible. The initial registration is required within 30 days of the organization's initial receipt of property. New organizations may not be able to state definitively, within this time period, whether contributions are deductible, as they are unlikely to have an IRS ruling or determination before the due date of the registration (the IRS prohibits most organizations from stating that contributions are deductible prior to receipt of the exempt determination letter).

A minor point regarding the regulations: The federal employer identification number is not the same as a group exemption number. It appears that the language in section 300 (b)(4) needs clarification, as most applicants will not have or need a group exemption number.

### Analysis

Sections 300 (b) (11) and (12) require that the organization submit a copy of its governing documents, such as articles of incorporation for corporations or trust instruments for trusts, and its bylaws. Section 300 (b) (13) requires that the organization attach a copy of the federal exemption determination letter or the copy of IRS Form 1023, if available.

The difficulty with these requirements is a practical one: except for the articles of incorporation or comparable charter documents, new organizations may not have completed the drafting and adoption of the bylaws or other corporate documents within the first 30 days following receipt of assets. In fact, funding of initial start-up expenses may be required before the process can be completed (for this reason, federal tax-exempt status is generally retroactive to the date of incorporation). Although it is appropriate to include the documents if the organization has completed these steps, many organizations may still be in the process of finalizing their governance provisions.

New organizations also need to prepare and file tax exemption applications. As the Attorney General is probably aware, the complexity of the preparation of the IRS application has increased dramatically, which has increased the amount of time and effort required to complete the process. As a result, it is not uncommon for the applications still to be incomplete 30 days from the first receipt of assets. In fact, the cost of the preparation and the requisite filing fees virtually guarantee that a nonprofit organization will need to receive at least some contributions in order to pay these start up expenses before filing the application, unless these costs are being covered by an already existing nonprofit. Thus, the vast majority of new nonprofit organizations will not be able to submit a finalized Form 1023 with the registration statement because they will not have completed the preparation of Form 1023. Further, in virtually all instances new organizations are not receiving federal determination letters from the IRS until a significant amount of time after submission of their Form 1023, because of the extended IRS processing time.

While the proposed regulation requires delivery of the Form 1023 and the determination letter with the original registration *only* if available, absence of them at that point *does* have a practical implication that needs to be addressed. The proposed regulations would require a new organization to provide information regarding its tax-exempt status, which could require these new organizations to violate the Internal Revenue Code. The IRS determination letter sets forth whether contributions to the organization are tax deductible. Until the IRS issues its determination letter, most organizations are legally prohibited from making an affirmative statement that contributions are deductible. The organization may affirm that it expects to receive an exempt determination letter confirming that contributions will be deductible (which, if the application is filed within 27 months of the date of formation, will be retroactive to the date of incorporation), but it would be in violation of federal law to make a definitive statement to this effect.

Even the most well funded organizations, with regular legal representation, may run into the problems described above. The problems are exacerbated for organizations that rely upon pro bono representation, as well as for the attorneys trying to fulfill this need.

Each exempt organization needs an employer identification number. This must be established before the organization can file with the Internal Revenue Service, pay employees, or open a bank account. It is our understanding that this is what is being requested by Section 300 (b)(3). Some exempt organizations do not file individually with the Internal Revenue Service to establish their exempt status; rather they come under a group exemption that covers related entities. Only if the organization chooses to come under an already established group exemption, rather than filing to establish its individual exemption, will it have a group exemption number, which is what appears to be addressed by Section 300 (b)(4).

#### Conclusion and Recommendation

The proposed regulations should allow for an initial registration submission, to be supplemented by later submissions as the corporate documents and tax information become available.

Section 300 (b)(4) of the proposed regulations should be amended to read: "Group exemption number from the Internal Revenue Service (if applicable)."

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Thank you for your attention to this matter. Please do not hesitate to contact the undersigned or any of the members of the Drafting Committee if you have any questions on the matters raised in this letter.

**Please note that the positions set forth in this letter are only those of the Committee. As such, they have not been adopted by the Section or its overall membership, or by the**

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Very truly yours,

Lisa A. Runquist  
Chair, 2006-07

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